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Economic Outlook

Irving Trust

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Low oil prices are causing oil companies to cut back wherever possible, while numerous signs of weakness in the economy are still evident. Nevertheless, the combination of substantial dollar depreciation, a precipitous decline in oil prices, and the lowest interest rates since 1977-1978 indicates that stronger economic growth still lies ahead. Real GNP is now expected to rise 3.6% from the fourth quarter of 1985 to the fourth quarter of 1986, somewhat less than previously projected but still higher than the comparable 2.1% increase last year.

One highly visible trouble spot of late is the auto industry. GM recently announced the biggest cutback in production since 1982. Dealers' inventories of GM cars are estimated to be about 85 days' supply, compared to a "normal" supply of about 60 days. Chrysler's supply is also well above normal, while Ford's supply is normal. As expected, a new round of more aggressive incentive financing has just been introduced by GM.

In 1985, auto output accounted for 2.9% of real GNP, up from 2.1% in 1982 but hardly changed from earlier years with strong sales. Although this may not seem to be a large component of GNP, developments in the auto industry have influenced the overall pace of GNP growth. Rebounds in auto output added slightly more than one percentage point to real GNP growth in the first and third quarters of last year, while sharp declines in auto output in the second and fourth quarters similarly reduced real GNP growth by slightly more than one percentage point. In the current quarter, a reduction in auto output will probably reduce real GNP growth by more than one percentage point as production is curtailed to reduce excessive inventories.

With several years of high auto sales behind us, it is not surprising that sales are faltering; the pent-up demand carried over from the recession has long been satisfied. Nevertheless, the auto makers do have one important factor in their favor. Despite high sales levels, the stock of cars has continued to age during the last few years, to the point that the average age of cars in use rose to 7.6 years in 1985, the highest since 1950. With more than 115 million cars on the road today, potential replacement demand is substantial, although the decision to purchase a car is still highly discretionary. Auto sales are expected to total 10.7 million units this year and 10.1 million next year, compared to 11.1 million in 1985. Domestic sales are expected to decline from 8.3 million units in 1985 to 7.8 million in 1986 and 7.2 million in 1987.

Although low oil prices are welcomed by most consumers, the economy has not seemed to respond yet to the effective net stimulus. To put the price decline into perspective, a 30%-40% decline in gasoline and heating oil prices translates to a savings of (quite coincidentally) about $30-$40 per household per month. This is simply too small a sum to influence spending decisions right away. Over time, however, as families' checking account balances begin to look better than anticipated or as outstanding credit card balances are worked down, spending could perk up, though not necessarily on big ticket items. Even the March retail sales report of a month-to-month decline of 0.8% was not as bleak as it may seem. Excluding autos and gasoline, sales rose by a respectable 0.6%, helped along by seasonably warm weather.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual 1985				Forecast 1986				Actual	Actual	Forecast
	I	II	III	IV	I	II	III	IV	1983-1984	1984-1985	1985-1986
Gross National Product	6.9	4.5	5.8	4.3	5.0	5.1	7.1	8.8	11.0	5.7	5.4
Real GNP	3.7	1.1	3.0	0.7	3.0	3.2	4.3	4.0	6.6	2.2	2.7
GNP Price Deflator	3.0	3.3	2.9	3.3	2.1	1.8	2.6	4.7	4.0	3.3	2.7

	Actual 1985: IV	Forecast 1986: I	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Spending	4.5%	4.0%	8.7%	6.6%	2.4%
Durable Goods	-14.1	3.1	14.3	9.2	0.8
Nondurable Goods	6.2	-1.8	6.8	4.6	1.6
Services	4.1	6.3	8.6	7.3	3.4
Business Capital Spending	12.2	-0.9	20.1	11.3	2.7
Structures	10.0	11.7	17.0	15.3	3.4
Equipment	13.5	-7.0	21.7	9.2	2.3
Residential Investment	13.3	18.9	17.8	3.6	10.7
			1984	1985	1986
Change in Inventories	$-4.3b.	$6.0b.	$67.4b.	$7.5b.	$5.4b.
Net Exports of Goods and Services	$-133.4b.	$-101.9b.	$-59.2b.	$-78.5b.	$-124.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	12.4%	-3.8%	9.0%	10.7%	4.0%
Federal	23.8	-14.3	9.9	13.6	5.9
Defense	3.3	10.1	9.9	10.5	6.5
Other	97.4	-43.8	9.8	33.2	4.1
State & Local	4.2	5.8	8.4	8.5	2.4
Corporate Profits Before Tax	5.2*	11.3*	18.9	-4.6	11.0
Corporate Profits After Tax	6.3*	11.2*	10.9	-2.2	9.5
Plant and Equipment Expenditures	0.1*	5.3*	16.3	8.4	2.0
Real Final Sales#	1.1	1.8	4.2	1.9	2.8
Real Disposable Personal Income	2.1	1.2	3.7	1.6	3.4

Economic Indicators	Recent Data Jan.	Feb.	Mar.	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Price Index**	3.6%	+4.8%	n.a.	4.0%	3.8%	2.7%
Producer Price Index for Finished Goods**	-8.4	-10.2	-13.2	1.7	1.8	0.1
Industrial Production	0.1	-0.5	n.a.	11.3	2.2	2.8
Retail Sales##	-0.2	0.1	-0.8	10.3	6.5	3.2
				1984	1985	1986
Auto Sales (millions of units, a.r.)	11.3	10.3	n.a.	10.4	11.1	10.7
Housing Starts (millions of units, a.r.)	2.06	1.99	n.a.	1.75	1.74	1.85
Unemployment Rate	6.7%	6.6%	6.6%	7.5%	7.2%	6.7%
Merchandise Trade Deficit (a.r.)	$107.3b.	$140.9b.	n.a.	$123.6b.	$144.6b.	$155.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

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#GNP less change in inventories, both in real terms
*Year-over-year percent changes
##Monthly percent changes are not annualized
**Annual percent changes are December to December (not seasonally adjusted)

$b. = billions a.r. = annual rate F = Forecast